

4. INSURANCE CLAIMS

MODEL WISE ANALYSIS OF PAST EXAM PAPERS OF IPCC

MODEL NO.	N-11	M-12	N-12	M-13	N-13	M-14	N-14	M-15	N-15	M-16	N-16
Model – 1	-	-	-	05	-	-	08	-	-	-	-
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Model – 1 : Computation of Average Clause

Model – 2 : Treatment of fire fighting Expenses

Model – 3 : Change in Policy

Model – 4 : Change in % of GP

Model – 5 : Abnormal items

Model – 6 : Loss of Profit

Model – 7 : Loss of Stock and loss of profit

Model – 8 : Theory

Insurance means a contract of indemnity (guarantee) whereby one party, called the insurer, undertakes to indemnify the loss suffered by other party, called the insured, on the happening of some unforeseen event in consideration of a fixed sum of money, called the premium.

Liability of the insurer is limited to the amount of loss actually suffered by the insured or the policy amount, whichever is less. In case of under insurance, liability of the insurer is limited to the extent of coverage only. (i.e. by application of average clause.)

Types of risks covered by a Fire Insurance Policy:

- I) Loss of stock in trade
- II) Loss of profit that may arise due to dislocation of business caused by fire.

I) Computation of Loss of Stock in Trade: It depends upon the following situations:

1. **Where proper stock records are maintained and such records are not destroyed by fire:** In such a case no difficulty is faced in determining the value of stock as at date of fire and the amount of claim.

Computation of amount of claim

Value of stock on the date of fire as per stock register	XXXX
less: Salvage value	XXXX
Loss of stock:	XXXX

Note: If necessary, average clause should be applied to determine the amount of claim.

2. **Where proper stock records are not maintained or such records are destroyed by fire:** In such a case, although it is difficult to determine the exact value of stock as at the date of fire, fairly reasonable estimate can be made as per the following steps.

Step 1: Preparation of Memorandum Trading A/c from the beginning of the year to the date of fire and ascertainment of "Value of stock destroyed by fire."

Note:

- ▶ If the percentage of gross profit is mentioned then it should be applied for the computation of G.P. for the year of fire.
- ▶ If the percentage of gross profit is not given then last year Gross profit percentage should be taken as base which should be computed by preparing last years trading A/c.

Step 2: Computation of amount of claim will be as given above.

Note: If necessary, average clause should be applied to determine the amount of claim.

3. **Where books of accounts are also destroyed:** Where books of accounts are destroyed, the task of building up the Trading Account becomes difficult. In that case information is obtained from the customers and suppliers have to be circularized to ascertain the amount of sales and purchases.

Important points to be noted:

1. Meaning of Fire

- a) Fire (whether resulting from explosion or otherwise) not occasioned or happening through:
- i) Its own spontaneous fomentation or heating or its undergoing any process involving the application of heat;
 - ii) Earthquake, subterraneous fire, riot, civil commotion, war, invasion act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power.
- b) Lightning.
- c) Explosion, not occasioned or happening through any of the perils specified in 1 (a) above.
- i) of boilers used for domestic purposes only;
 - ii) of any other boilers or economisers on the premises;
 - iii) In a building not being any part of any gas works or gas for domestic purposes or used for lighting or heating the building.

2. **Average Clause:** This clause is applicable only when the goods/property was under insured i.e., where he has not taken sufficient insurance to cover the value of the property insured. In such a case the claim of the insured would be based on the following formula.

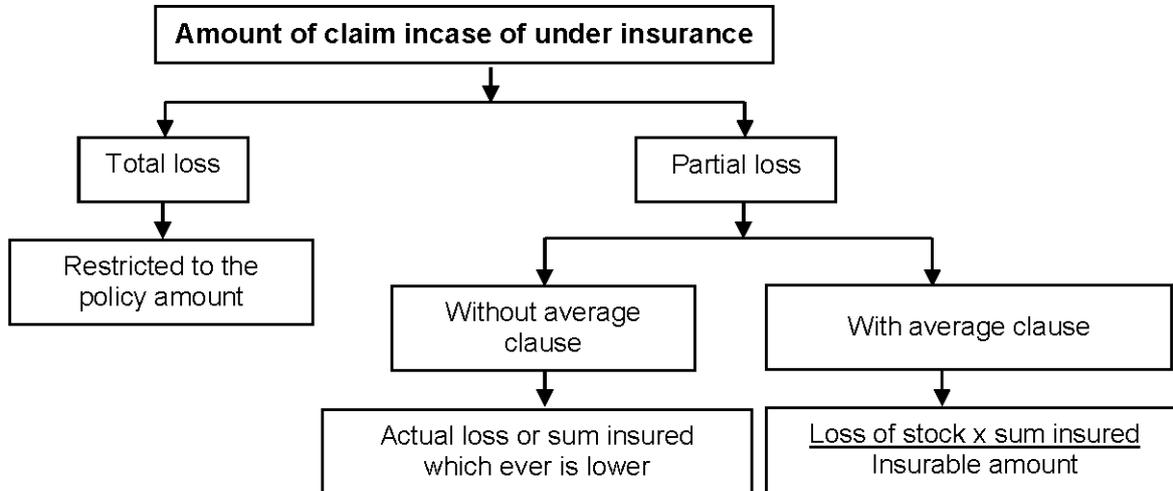
$$\text{Amount of Claim} = \text{Loss of stock} \times \frac{\text{Sum Insured}}{\text{Insurable amount}}$$

The objective of average clause is discouraging the insured to make under insurance.

(Nov-05, May-09)

3. In arriving at the G.P. percentage on the basis of last year accounts, care should be taken about the mode of the valuation of opening and closing stocks. i.e., if stock in the last year has not been valued at cost, the valuation should be adjusted first at cost to determine the appropriate G.P. percentage and opening stock of the current period should also be taken at cost as the basis of valuation of stock is essentially the cost.
4. Fire insurance being a contract of indemnity, a claim can be lodged only for the actual amount of the loss, not exceeding the insured value. In dealing with problems requiring determination of the claim the following point must be noted.
- a) **Total loss:** If the goods are totally destroyed, the amount of claim is equal to the actual loss, provided the goods are fully insured. However, incase of under insurance (i.e. insurable value of stock insured is more than the sum insured), the amount of claim is restricted to the policy amount.

- b) **Partial loss:** If the goods are partially destroyed, the amount of claim is equal to the actual loss provided the goods are fully insured. However in case of underinsurance, the amount of claim will depend upon the nature of insurance policy as follows:
- Without average clause:** Claim is equal to the lower of actual loss or the sum insured.
 - With average clause:** Amount of claim for loss of stock is proportionately reduced, considering the ratio of policy amount (i.e. insured amount) to the value of stock as on the date of fire (i.e. insurable amount) as shown below.



- Average GP Ratio:** Whenever more than one earlier year's data is given, then Gross profit rate of each year should be calculated and average should be taken. (either simple/weighted average).
- Abnormal Loss:**
 - While calculating the GP ratio of earlier year, or the cost of stock of this year etc., the cost / sale value of abnormal item (i.e. items which are not valued, purchased, sold at normal prices) should be excluded / adjusted while preparing trading account.
 - After calculating stock, such abnormal item it was lying in stock should be added at lower of cost or realizable value to get total cost on the date of fire.

Salvage: Salvage refers to goods saved from fire. It is true that the insurer has the right to take away the goods salvaged. But, usually, is retained by the insured himself.

The treatment of salvage depends upon the facts of each case. If the salvage is retained by the insured, then the value of salvage should be deducted from the value of stock as on date of fire, and the resulting amount should be considered as the amount of stock lost by fire for the purpose of claim.

Frequently salvaged stock can be made saleable after it is reconditioned. In that case, the cost of such stock must be credited to the Trading Account and debited to a salvaged stock account. The expenses on reconditioning must be debited and the sales credited to this account, the final balance being transferred to the Profit & Loss Account.

On the other hand, if the salvage is taken over by the insurer, then the value of salvage should not be deducted from the value of stock as on the date of fire. In this case, the entire value of stock as on the date of fire should be considered as the amount of stock lost by fire for the purpose of claims i.e. in this case damaged stock is subrogated to the insurance company.

Expenses incurred by the insured to extinguish fire: Sometimes, some expenses might have been incurred by the insured to extinguish (i.e., to put down) the fire. In such a case the amount of the expenses should be added with the value of stock lost by fire for the purpose of claim.

II) Computation of Loss of Profits (Consequential Loss Policy):

- When due to accident like fire, earthquake etc. the properties of an organization are destroyed, it will take some time to restore it back to normal.

2. As a consequence business gets disturbed. During this period either will be no sales or sales will be significantly less as result organization losses the profit which it could have earned on such sale.

The fire caused not only destroys the assets of the business, but also affect the production and sale of business. During the period of dislocation, the sales, recovery of standing charges and earnings all decline substantially. Consequently, the loss of profit arises. Such loss cannot be covered by ordinary fire policy. Therefore the loss of profit can be insured against by Loss of Profit or Consequential Loss policy. The loss of profit policy covers:

- i. Loss of profits due to dislocation of business.
- ii. Non recovery of fixed or standing charges (The insured should specify the standing charges he likes to insure).
- iii. Increased working stock incurred by the insured during the period of indemnity.

Step 1. Computation of short sales:

Standard turnover	XXXX
Add/Less: Increase or decrease in turn over (Trend)	<u>XXXX</u>
Adjusted standard turnover	XXXX
Less: Actual turnover or indemnity turnover	<u>XXXX</u>
Short sales	<u>XXXX</u>

Step 2. Computation of GP%:

NP of last year (before tax)	XXXX
Add: Insured standing charges	<u>XXXX</u>
Adjusted NP	<u>XXXX</u>
Turnover of last year	XXXX
$GP\% = \frac{\text{Adjusted NP}}{\text{Last year turnover}} \times 100$	

Step 3. Computation of loss of profits:

Loss of profits = Short Sales X GP%

Step 4. Computation of adjusted annual Turnover:

Annual turnover	XXXX
Add/Less: Increase/decrease in turnover (Trend)	<u>XXXX</u>
Adjusted Annual Turnover	<u>XXXX</u>

Step 5. GP on adjusted annual turnover:

GP on adjusted annual turnover = Adjusted annual turnover X GP%

Step 6. Computation of claim for additional expenses:

1. Actual additional expenditure incurred	XXXX
2. $\frac{\text{Additional expn.} \times \text{GP on AAT}}{\text{GP on AAT} + \text{Uninsured standing charges}}$	XXXX
3. GP on sales generated by additional expen. (Additional turnover)	XXXX

The claim for add. expen. will be lower of above three.

Step 7. Computation of gross claim:

Loss of profits as per step-3	XXXX
Add: Additional expenses as per step-6	XXXX

Less: Saving in insured standing charges XXXX

Gross claim XXXX

Step 8. Computation of net claim:

$$\text{Net claim} = \frac{\text{Amt. of policy}}{\text{GP on adj. ann. turnover}} \times \text{gross claim}$$

Note: If GP on adjusted annual turnover > policy amount, average clause is applicable. Otherwise step-7 will be the last step.

Insurable value under loss of profit policy is Gross profit on Adjusted Annual turnover.

Glossary:

1. **Indemnity Period:** It means the period commenced on the date of damage caused by fire and ending on the date when normality is restored. The insured selects such period by himself. The insurer can indemnify the loss only for the indemnity period.
2. **Claim period:** Claim is available for the indemnity period or actual period of interruption which ever is lower.
3. **Standard Turnover:** It is the sales during the period in a year immediately preceding the date of fire corresponding with the indemnity period.
4. **Short sales:** It refers to the loss of sales arising due to the business dislocation. It is the difference between standard sales and actual sales during the period of indemnity.
5. **Annual Turnover:** It is the sales during a year immediately preceding the date of fire.
6. **Standing Charges:** Standing charges means, the expenses of fixed nature, which doesn't change even when production or sale changes, interest, rent, rate, taxes claims and wages of skilled labour etc, are generally insured standing charges (i.e., charges which are covered under terms of policy).

$$\text{Total Standing Charges} = \text{Insured Standing Charges} + \text{Uninsured Standing charges}$$

7. **Increased Working Cost:** The insured may incur some additional expenses for business stay during the post fire period to avoid reduction in sales. In loss of profit policy, average clause is inserted to cover the increase in working cost with the objective of avoiding the loss of sales.

Trend in turnover:

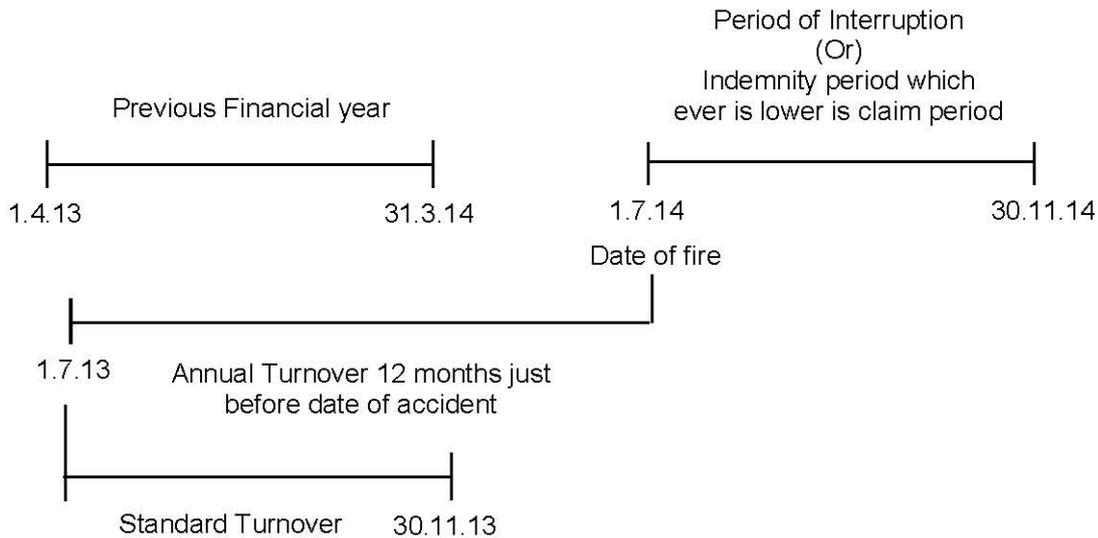
1. The annual turnover and standard turnover should be adjusted for any upward or downward trend in turnover. If agreed percentage of increase / decrease is given then that is to be applied for calculating adjusting turnover.
2. Otherwise the trend (% of increase / decrease) can be calculated when more than one financial year sales are given. Calculation of trend by comparing annual turnover and previous year turnover although not very correct but can be calculated as follows and applied if required by the question.

$$= \frac{\text{Annual Turnover} - \text{Turnover of last financial year}}{\text{Turnover of last financial year}} \times 100$$

3. Trend indicates whether future turnover is expected to be more or less than past period turnover.

Tutorial Note: Insurance company will provide claim at fair value on damaged goods and at cost on normal goods.

Example:



Note: How to record the short fall in claim settlement by Insurance Company (Insurer) in the books of the company (Insured).

Journal Entry

Profit and Loss A/c Dr. (To the extent of shortfall amount)

 To Insurance Company A/c

(Being the shortfall in insurance claim is the loss, transfer to Profit and Loss Account)

PROBLEMS FOR CLASSROOM DISCUSSION

Problem 1: Computation of claim by application of average clause: On 30th March, 2012 fire occurred in the premises of M/s Suraj Brothers. The concern had taken an insurance policy of Rs. 60,000 which was subject to the average clause. From the books of accounts, the following particulars are available relating to the period 1st January to 30th March 2012.

1. Stock as per Balance Sheet at 31st December, 2011, Rs. 95,600.
2. Purchases (including purchase of machinery costing Rs. 30,000) Rs. 1,70,000
3. Wages (including wages Rs. 3,000 for installation of machinery) Rs. 50,000.
4. Sales (including goods sold on approval basis amounting to Rs. 49,500) Rs. 2,75,000. No approval has been received in respect of 2/3rd of the goods sold on approval.
5. The average rate of gross profit is 20% of sales.
6. The value of the salvaged goods was Rs. 12,300.

You are required to compute the amount of the claim to be lodged to the insurance company.

(Nov 16) (PM) (Ans: Insurance Claim = Rs.48,211)

(Solve Problem No: 1 of Assignment problem as rework)

Note: _____

Problem 2: (PRINTED SOLUTION AVAILABLE) Computation of claim by application of average clause: On 20th October, 2009, the godown and business premises of Aman Ltd. were affected by fire. From the salvaged accounting records, the following information is available.

Particulars	Rs.
Stock of goods @ 10% lower than cost as on 31 st March, 2009	2,16,000
Purchases less returns (01.04.2009 to 20.10.2009)	2,80,000
Sales less returns (01.04.2009 to 20.10.2009)	6,20,000

Additional Information:

- Sales upto 20th October, 2009 includes Rs. 80,000 for which goods had not been dispatched.
- Purchases upto 20th October, 2009 did not include Rs.40,000 for which purchase invoices had not been received from suppliers, though goods have been received in Godown.
- Past records show the gross profit rate of 25%
- The value of goods salvaged from fire Rs.31,000
- Aman Ltd. has insured their stock for Rs.1,00,000

Compute the amount of claim to be lodged to the insurance company.

(PM) (Ans.: Insurance Claim = Rs. 80,000)

(Solve Problem No: 2 of Assignment problem as rework)

Note: _____

Problem 3: (PRINTED SOLUTION AVAILABLE) Treatment of Fire fighting expenses: On 29th August, 2012, the godown of a trader caught fire and a large part of the stock of goods was destroyed. However, goods costing Rs.1,08,000 could be salvaged incurring fire fighting expenses amounting to Rs.4,700.

The trader provides you the following additional information:

Particulars	Rs.
Cost of stock on 1st April, 2011	7,10,500
Cost of stock on 31st March, 2012	7,90,100
Purchases during the year ended 31st March, 2012	56,79,600
Purchases from 1st April, 2012 to the date of fire	33,10,700
Cost of goods distributed as samples for advertising from 1st April, 2012 to the date of fire	41,000
Cost of goods withdrawn by trader for personal use from 1st April, 2012 to the date of fire	2,000
Sales for the year ended 31st March, 2012	80,00,000
Sales from 1st April, 2012 to the date of fire	45,36,000

The insurance company also admitted firefighting expenses. The trader had taken the fire insurance policy for Rs. 9,00,000 with an average clause. Calculate the amount of the claim that will be admitted by the insurance company.

(PM) (Ans: Amount of claim Rs.7,79,300)

(Solve Problem No: 3 of Assignment problem as rework)

Note: _____

Problem 4: Computation of claim for loss of stock with abnormal items: On 1st April, 2015 the stock of Shri Ramesh was destroyed by fire but sufficient records were saved from which following particulars were ascertained:

Particulars	Rs.
Stock at cost-1 st January, 2014	73,500
Stock at cost-31 st December, 2014	79,600
Purchases-year ended 31 st December, 2014	3,98,000

Sales-year ended 31 st December, 2014	4,87,000
Purchases 1.1.2015 to 31.3.2015	1,62,000
Sales 1.1.2015 to 31.3.2015	2,31,200

In valuing the stock for the Balance Sheet at 31st December, 2014 Rs.2,300 had been written off on certain stock which was a poor selling line having the cost Rs.6,900. A portion of these goods were sold in March, 2015 at loss of Rs.250 on original cost of Rs.3450. the remainder of this stock was now estimated to be worth its original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout the year.

The value of stock salvaged was Rs.5,800. The policy was for Rs.50,000 and was subject to the average clause. Work out the amount of the claim of loss by fire.

(May, 2008 – Similar Problem) (SM) (Ans.: Amount of claim Rs.45,004)
(Solve Problem No: 4 of Assignment problem as rework)

Note: _____

Problem 5: (PRINTED SOLUTION AVAILABLE) Computation of value of stock on date of fire and treatment of abnormal items: A fire occurred in the premises of M/s. Fireproof Co. on 31st August, 2011. From the following particulars relating to the period from 1st April, 2011 to 31st August, 2011 you are requested to ascertain the amount of claim to be filed with the insurance company for the loss of stock. The concern had taken an insurance policy for Rs.60,000 which is subject to average clause.

Particulars	Rs.
Stock as per Balance sheet at 31.03.2011	99,000
Purchases	1,70,000
Wages (including wages for the installation of a machine Rs.3,000)	50,000
Sales	2,42,000
Sale value of goods drawn by partners	15,000
Cost of goods sent to consignees on 16 th August, 2011, lying unsold with them	16,500
Cost of goods distributed as free samples	1,500

While valuing the stock at 31st March, 2011, Rs.1,000 were written off in respect of a slow moving item. The cost of which was Rs.5,000. A portion of these goods were sold at a loss of Rs.500 on the original cost of Rs.2,500. The remainder of the stock is now estimated to be worth the original cost. The value of goods salvaged was estimated at Rs.20,000. The average rate of gross profit was 20% throughout. (Nov. 2011, PM) (Ans.: Claim Rs.47,027)

(Solve Problem No: 5, 6 of Assignment problem as rework)

Note: _____

Problem 6: Computation of Statement of claim for stock along with buildings & equipment: A fire engulfed the premises of a business of M/s Preet on the morning of 1st July 2013. The building, equipment and stock were destroyed and the salvage recorded the following:

Building – Rs.4,000; Equipment – Rs.2,500; Stock – Rs.20,000. The following other information was obtained from the records saved for the period from 1st January to 30th June 2013:

Particulars	Rs.
Sales	11,50,000
Sales Returns	40,000
Purchases	9,50,000
Purchases Returns	12,500
Cartage inward	17,500

Wages	7,500
Stock in hand on 31st December, 2012	1,50,000
Building (value on 31st December, 2012)	3,75,000
Equipment (value on 31st December, 2012)	75,000
Depreciation provision till 31st December, 2012 on:	
Building	1,25,000
Equipment	22,500

No depreciation has been provided since December 31st 2012. The latest rate of depreciation is 5% p.a. on building and 15% p.a. on equipment by straight line method. Normally business makes a profit of 25% on net sales. You are required to prepare the statement of claim for submission to the Insurance Company. **(May - 2014, RTP) (Ans: Rs.5,41,000)**

Note: _____

Problem 7: (PRINTED SOLUTION AVAILABLE) Determination of claim in loss of profit policy: On Account of a fire on 15th June, 2011 in the business house of a company, the working remained disturbed upto 15th December 2011 as a result of which it was not possible to affect any sale. The company had taken out an insurance policy with an average clause against consequential losses for Rs.1,40,000 and a period of 7 months has been agreed upon as indemnity period. An increase of 25% was marked in the current year's sales as compared to the last year. The company incurred an additional expenditure of Rs.12,000 to make sales possible and made a saving of Rs.2,000 in the insured standing charges.

Particulars	Rs.
Actual sales from 15 th June, 2011 to 15 th Dec. 2011	70,000
Sales from 15 th June 2010 to 15 th Dec. 2010	2,40,000
Net profit for last financial year	80,000
Insured standing charges for the last financial year	70,000
Total standing charges for the last financial year	1,20,000
Turnover for the last financial year	6,00,000
Turnover for one year – 16 June 2010 to 15 June 2011	5,60,000

(PM) (Nov., 2003) (Ans.: Total Claim for consequential loss of profit – Rs.51866.40)
(Solve Problem No: 9 of Assignment problem as rework)

Note: _____

Problem 8: (PRINTED SOLUTION AVAILABLE) Determination of claim in loss of profit policy: X Ltd. has insured itself under a loss of profit policy for Rs.3,63,000. The indemnity period under the policy is six months. On 1st September, 2010 a fire occurred in the factory of X Ltd. and the normal business was affected upto 1st March, 2011.

The following information is compiled for the year ended on 31st March, 2010.

Particulars	Rs.
Sales	20,00,000
Insured standing charges	2,40,000
Uninsured standing charges	20,000
Net Profit	1,20,000

Following further details of turnover are furnished.

- Turnover during the period of 12 months ending on the date of fire was 22,00,000.
- Turnover during the period of interruption was Rs.2,25,000.

- c. Actual turnover during the period from 01.09.2009 to 01.03.2010 during the preceding year corresponding to the indemnity period was Rs.7,50,000.

X Ltd. spent an amount of Rs.40,000 as additional cost of working during the indemnity period. On account of this additional expenditure:

- There was a saving of Rs.15,000 in insured standing charges during the period of indemnity.
- Reduced turnover avoided was Rs.1,00,000. i.e. but for this expenditure, the turnover after the date of fire would have been only Rs.1,25,000.

A special clause in the policy stipulates that owing to the reasons acceptable to the insurer under the special circumstances the following increases are to be made:

- Increase of turnover standard and actual by 10%
- Increase in rate of gross profit by 2% from previous year's level.

X Ltd. asks you to compute the claim for loss of profit. All calculations should be to the nearest rupee.

(PM) (May 1999) (Ans.: Amount of claim Rs.93,750)

(Solve Problem No: 10 of Assignment problem as rework)

Note: _____

Problem 9: Comprehensive problem on loss of stock policy, loss of profit policy: Ramda & Sons had taken out policies (without Average Clause) both against loss of stock and loss of profit, for Rs. 2,10,000 and Rs. 3,20,000 respectively. A fire occurred on 1st July, 2011 and as a result of which sales were seriously affected for a period of 3 months.

Trading and Profit & Loss A/c of Ramda & Sons for the year ended on 31st March, 2011 is given below:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Opening Stock	96,000	By Sales	12,00,000
To Purchases	7,56,000	By Closing Stock	1,85,000
To Wages	1,58,000		
To Manufacturing Expenses	75,000		
To Gross Profit c/d	3,00,000		
	13,85,000		13,85,000
To Administrative Expenses	83,600	By Gross Profit b/d	3,00,000
To Selling Expenses (Fixed	72,400		
To Commission on Sales)	34,200		
To Carriage Outward	49,800		
To Net Profit	60,000		
	3,00,000		3,00,000

Further detail provided is as below:

- a) Sales, Purchases, Wages and Manufacturing Expenses for the period 1.04.2011 to 30.06.2011 were Rs.3,36,000, Rs.2,14,000, Rs.51,000 and Rs.12,000 respectively.

- b) Other Sales figure were as follows
- | | Rs. |
|-------------------------------|----------|
| From 01.04.2010 to 30.06.2010 | 3,00,000 |
| From 01.07.2010 to 30.09.2010 | 3,20,000 |
| From 01.07.2011 to 30.09.2011 | 48,000 |

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- c) Due to decrease in the material cost, Gross Profit during 2011-12 was expected to increase by 5% on sales.

d) Rs.1,98,000 were additionally incurred during the period after fire. The amount of policy included Rs.1,56,000 for expenses leaving Rs. 42,000 uncovered.

Compute the claim for stock, loss of profit and additional expenses (PM)
 (Ans: Claim for loss of Stock Rs.2,10,000: Claim for loss of profit Rs.82,432)
 (Solve Problem No: 11& 13 of Assignment problem as rework)

Note: _____

Problem 10: Insurance Claim for Loss of Profit: From the following particulars, you are required to calculate the amount of claim for Build well Ltd., whose business premises was partly destroyed by fire:

Sum insured (from 31st December 2013) Rs.4,00,000

Period of indemnity 12 months, Date of damage 1st January, 2014

Date on which disruption of business ceased 31st October, 2014

The subject matter of the policy was gross profit but only net profit and insured standing charges are included.

The books of account revealed:

- The gross profit for the financial year 2013 was Rs.3,60,000.
- The actual turnover for financial year 2013 was Rs.12,00,000 which was also the turnover in this case.
- The turnover for the period 1st January to 31st October, in the year preceding the loss, was Rs.10,00,000.

During dislocation of the position, it was learnt that in November-December 2013, there has been an upward trend in business done (compared with the figure of the previous years) and it was stated that had the loss not occurred, the trading results for 2014 would have been better than those of the previous years.

The Insurance company official appointed to assess the loss accepted this view and adjustments were made to the pre-damaged figures to bring them up to the estimated amounts which would have resulted in 2014.

The pre-damaged figures together with agreed adjustments were:

Period	Pre-damaged figures (Rs.)	Adjustment to be added (Rs.)	Adjusted standard turnover (Rs.)
January	90,000	10,000	1,00,000
Feb. to October	9,10,000	50,000	9,60,000
November to December	2,00,000	10,000	2,10,000
Gross Profit	12,00,000	70,000	12,70,000
	3,60,000	46,400	4,06,400

Rate of Gross Profit 30% (actual for 2013), 32% (adjusted for 2014).

Increased cost of working amounted to Rs.1,80,000.

There was a clause in the policy relating to savings in insured standard charges during the indemnity period and this amounted to Rs.28,000.

Standing Charges not covered by insurance amounted to Rs.20,000 p.a. The actual turnover for January was nil and for the period February to October 2014 Rs.8,00,000.

(May-2013, Study Material)

(Ans: Insurance claim will be Rs.2,22,247)

(Solve Problem No: 12 of Assignment problem as rework)

Note: _____

Problem 11: (PRINTED SOLUTION AVAILABLE) Determination of claim in loss of profit policy: A firm has decided to take out of loss of profit policy for the year 2016 and given the following information for the last accounting year 2015.

Variable manufacturing expenses Rs. 14,20,000, Standing charges Rs. 1,50,000, Net profit Rs. 80,000, Non-operating income Rs. 2,500, Sales Rs. 18,00,000.

Compute the sum to be insured in each of the following alternative cases showing the anticipation for the year 2016:

- i) If sales will increase by 15%.
- ii) If sales will increase by 15% and only 50% of the present standing charges are to be insured.
- iii) If sales and variable expenses will increase by 15% and standing charges will increase by 10%.
- iv) If sales will increase by 15% and variable expenses will decrease by 5%.
- v) If sales will increase by 10% and standing charges will increase by 15%.
- vi) If the turnover and standing charges will increase by 15% and variable expenses will decrease by 10% but only 50% of the present standing charges are to be insured.

(May 2016)

(Solve Problem No: 7 and 8 of Assignment problem as rework)

Note: _____

ASSIGNMENT PROBLEMS

Problem 1: Computation of claim by application of average clause: A fire occurred in the premises of M/S Kailash & Co. on 30th September 2013. From the following particulars relating to the period from 1st April 2013 to 30th September 2013, You are required to ascertain the amount of claim to be filed with the insurance company for the loss of stock. The company has taken an Insurance policy for Rs.75,000 which is subject to average clause. The value of goods salvaged was estimated at Rs.20,000. The average rate of gross profit was 20% throughout the period.

Particulars	Amount (Rs.)
Opening stock	1,20,000
Purchases made	2,40,000
Wages paid(including wages for the installation of a machine Rs.5,000)	75,000
Sales	3,10,000
Goods taken by the proprietor (sale value)	25,000
Cost of goods sent to consignee on 20 th September 2013, lying unsold with them	18,000
Free samples distributed-cost	2,500

(PM) (Nov-14-5(a)) (Ans: Claim of stock Rs.60,689)

Problem 2: Computation of claim by application of average clause: On 2.6.2014 the stock of Mr. Black was destroyed by fire. However, following particulars were furnished from the records saved:

Particulars	Amount (Rs.)
Stock at cost on 1.4.2013	1,35,000
Stock at 90% of cost on 31.3.2014	1,62,000
Purchases for the year ended 31.3.2014	6,45,000
Sales for the year ended 31.3.2014	9,00,000
Purchases from 1.4.2014 to 2.6.2014	2,25,000
Sales from 1.4.2014 to 2.6.2014	4,80,000

Sales upto 2.6.2014 includes Rs. 75,000 being the goods not dispatched to the customers. The sales invoice price is Rs. 75,000.

Purchases upto 2.6.2014 includes a machinery acquired for Rs. 15,000.

Purchases upto 2.6.2014 does not include goods worth Rs. 30,000 received from suppliers, as invoice not received upto the date of fire. These goods have remained in the godown at the time of fire. The insurance policy is for Rs. 1,20,000 and it is subject to average clause. Ascertain the amount of claim for loss of stock. (RTP - Nov-15)(Ans: Claim Rs.1,20,000)

Problem 3: Treatment of fire fighting expenses: On 30th June, 2011, accidental fire destroyed a major part of the stocks in the godown of Jay Associates. Stock costing Rs.30,000 could be salvaged but not their stores ledgers. A fire insurance policy was in force under which the sum insured was Rs.3,50,000. From available records, the following information was retrieved:

- Total of sales invoices during the period April-June amounted to Rs.30,20,000. An analysis showed that goods of the value of Rs.3,00,000 had been returned by the customers before the date of the fire.
- Opening stock on 1.4.2011 was Rs.2,20,000 including stocks of value of Rs.20,000 being lower of cost and net value subsequently realised.
- Purchases between 1.4.2011 and 30.6.2011 were Rs.21,00,000.
- Normal gross profit rate was 33 1/3% on sales
- A sum of Rs.30,000 was incurred by way of fire fighting expenses on the day of the fire.

Prepare a statement showing the insurance claim recoverable. (PM) (Ans.: Claim Rs.3,50,000)

Problem 4: Computation of claim for loss of stock with abnormal items: On 19th May, 2011, the premises of Shri Garib Das were destroyed by fire, but sufficient records were saved, wherefrom the following particulars were ascertained:

Particulars	Rs.
Stock at cost on 1.1.2010	36,750
Stock at cost on 31.12.2010	39,800
Purchases less returns during 2010	1,99,000
Sales less return during 2010	2,43,500
Purchases less returns during 1.1.2011 to 19.5.2011	81,000
Sales less returns during 1.1.2011 to 19.5.2011	1,15,600

In valuing the stock for the balance Sheet as at 31st December, 2010, Rs.1,150 had been written off on certain stock which was a poor selling line having the cost Rs.3,450. A portion of these goods were sold in March, 2011 at a loss of Rs.125 on original cost of Rs.1,725. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exceptions, gross profit has remained at a uniform rate throughout. The stock salvaged was Rs.2,900.

Show the amount of the claim of stock destroyed by fire. Memorandum Trading Account to be prepared for the period from 1-1-2011 to 19-5-2011 for normal and abnormal items. (PM)
(Ans: Insurance claim Rs.26,125)

Problem-5: Computation of value of stock on date of fire and treatment of abnormal items: From the following information, ascertain the value of stock as on 31st March, 2012:

Particulars	Rs.
Stock as on 01-04-2011	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100
Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

At the time of valuing stock as on 31st March, 2011, a sum of Rs. 3,500 was written off on a particular item, which was originally purchased for Rs. 10,000 and was sold during the year for Rs. 9,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales. (PM) (Ans: Value of stock Rs.12,500)

Problem 6: Treatment of misappropriation of cash: The premises of Agni Ltd. caught fire on 22nd January 2011, and the stock was damaged.

The firm makes account up to 31st March each year. On 31st March, 2010 the stock at cost was Rs. 13,27,200 as against Rs. 9,62,200 on 31st March, 2009.

Purchases from 1st April, 2010 to the date of fire were Rs. 34,82,700 as against Rs. 45,25,000 for the full year 2009 -10 and the corresponding sales figures were Rs. 49,17,000 and Rs. 52,00,000 respectively.

You are given the following further information:

- In July, 2010, goods costing Rs. 1,00,000 were given away for advertising purposes, no entries being made in the books.
- During 2010-11, a clerk had misappropriated unrecorded cash sales. It is estimated that the defalcation averaged Rs. 2,000 per week from 1st April, 2010 until the clerk was dismissed on 18th August, 2010.
- The rate of gross profit is constant.

From the above information calculate the stock in hand on the date of fire. (RTP MAY-12)

(Ans: Stock on Date of Fire Rs.7,44,100)

Problem 7: Determination of claim in loss of profit policy: A fire occurred on 1st February, 2014 in the premises of Pioneer Ltd., a retail store and business was partially disorganised upto 30th June, 2014. The company was insured under a loss of profits for Rs.1,25,000 with a six months period indemnity. From the following information, compute the amount of claim under the loss of profit policy.

Actual turnover from 1 st February to 30 th June, 2014	80,000
Turnover from 1 st February to 30 th June, 2013	2,00,000
Turnover from 1 st February, 2013 to 31 st January, 2014	4,50,000
Net Profit for last financial year	70,000
Insured standing charges for last financial year	56,000
Total standing charges for last financial year	64,000
Turnover for the last financial year	4,20,000

The company incurred additional expenses amounting to Rs.6,700 which reduced the loss in turnover. There was also a saving during the indemnity period of Rs.2,450 in the insured standing charges as a result of the fire.

There had been a considerable increase in trade since the date of the last annual accounts and it has been agreed that an adjustment of 15% be made in respect of the upward trend in turnover. (SM) (Ans.: Net Claim Rs.39,390)

Problem 8: Determination of claim in loss of profit policy: The premises of XY Limited was partially destroyed by fire on 1st March, 2014 and as a result, the business was practically disorganised up to 31st August 2014. The company is insured under a loss of profits policy for Rs.1,65,000 having an indemnity period of 6 months. From the following information, ascertain the claim for loss of profit.

Actual turnover during the period of dislocating (1.3.14 to 31.8.14)	80,000
Turnover for the corresponding period in the (1.3.13 to 31.8.13)	2,40,000
Turnover for the 12 months immediately preceding the fire (1.3.13 to 28.2.14)	6,00,000
Net profit for the last financial year	90,000
Insured standing charge for the last financial year	60,000
Uninsured standing charges	5,000
Turnover for the last financial year	5,00,000

Due to substantial increase in trade, before and upto the time of the fire, it was agreed that an adjustment of 10% should be made in respect of the upward trend in turnover. The company incurred additional expenses amounting to Rs.9,300, immediately after the fire and but for this expenditure, the turnover during the period of dislocation would have been only Rs.55,000. There was also a saving during the indemnity period of Rs.2,700 in insured standing charges as a result of the fire. (Nov. 2008 – Similar Problem, SM) (Ans.: Net Claim Rs.50,000)

Problem 9: Comprehensive problem on loss of stock policy, loss of profit policy: S & M Ltd give the following Trading and P & L A/c for the year ended 31-12-2014.

Particulars	Amount	Particulars	Amount
To Opening stock	50,000	By Sales	8,00,000
To Purchases	3,00,000	By Closing stock	70,000
To Wages (Rs.20,000 for skilled labour)	1,60,000		
To Manufacturing expenses	1,20,000		
To Gross Profit (b/f)	2,40,000		
	8,70,000		8,70,000
To Office & Admn. Expenses	60,000	By Gross Profit b/d	2,40,000
To Advertising	20,000		
To Fixed selling expenses	40,000		
To Commission on sales	48,000		
To Carriage outwards	16,000		
To Net Profit	56,000		
	2,40,000		2,40,000

The company had taken out policies both against loss of stock and against loss of profits, the amounts being Rs.80,000 and Rs.1,72,000. Fire occurred on 1-5-2015 and as a result of which sales were seriously affected for the period of 4 months. You are given the following further information.

- Purchases, wages and other manufacturing expenses for the first 4 months of 2015 were Rs.1,00,000; Rs.50,000 and Rs.36,000 respectively.
- Sales for the same period were Rs.2,40,000
- Other sales figures were as follows:

From 1-1-2014 to 30-4-2014	3,00,000
From 1-5-2014 to 31-8-2014	3,60,000
From 1-5-2015 to 31-8-2015	60,000

- Due to rise in wages, net profit during 2015 was expected to decline by 2% on sales.
- Additional expenses incurred during the period after fire amounted to Rs.1,40,000. The amount of the policy included Rs.1,20,000 for expenses leaving Rs.20,000 uncovered. Ascertain the claim for stock and for loss of profit. All working should form part of your answer. (SM) (Ans.: Loss of Stock claim Rs.80,000, Loss of Profit Rs.57,600)

Problem 10: Sony Ltd.'s. trading and profit and loss account for the year ended 31st December, 2010 were as follows:

Trading and Profit and Loss Account for the year ended 31.12.2010

	Rs.		Rs.
Opening stock	20,000	Sales	10,00,000
Purchases	6,50,000	Closing stock	90,000
Manufacturing expenses	1,70,000		
Gross profit	2,50,000		
	2,50,000		2,50,000

The company had taken out a fire policy for Rs. 3,00,000 and a loss of profits policy for Rs. 1,00,000 having an indemnity period of 6 months. A fire occurred on 1.4.2011 at the premises and the entire stock was gutted with nil salvage value. The net quarter sales i.e. 1.4.2011 to 30.6.2011 was severely affected. The following are the other information:

Sales during the period	1.1.2011 to 31.3.2011	2,50,000
Purchases during the period	1.1.2011 to 31.3.2011	3,00,000
Manufacturing expenses	1.1.2011 to 31.3.2011	70,000
Sales during the period	1.4.2011 to 30.6.2011	87,500
Standing charges insured		50,000
Actual expense incurred after fire		60,000

The general trend of the industry shows an increase of sales by 15% and decrease in GP by 5% due to increased cost. Ascertain the claim for stock and loss of profit.

(Ans.: Stock destroyed by fire Rs. 2,60,000; and loss of profit Rs. 15,000)

Problem 11: Determination of claim in loss of profit policy: Monalisa & Co. runs plastic goods shop. Following details are available from quarterly sales tax return filed.

Sales	2009	2010	2011	2012
	Rs.	Rs.	Rs.	Rs.
From 1st January to 31st March	1,80,000	1,70,000	2,05,950	1,62,000
From 1st April to 30th June	1,28,000	1,86,000	1,93,000	2,21,000
From 1st July to 30th September	1,53,000	2,10,000	2,31,000	1,75,000
From 1st October to 31st December	1,59,000	1,47,000	1,90,000	1,48,000
TOTAL	6,20,000	7,13,000	8,19,950	7,06,000

Period

Rs.

Sales from 16-09-2011 to 30-09-2011	34,000
Sales from 16-09-2012 to 30-09-2012	Nil
Sales from 16-12-2011 to 31-12-2011	60,000
Sales from 16-12-2012 to 31-12-2012	20,000

A loss of profit policy was taken for Rs.1,00,000. Fire occurred on 15th September, 2012. Indemnity period was for 3 months. Net Profit was Rs.1,20,000 and standing charges (all insured) amounted to Rs.43,990 for year ending 31st December, 2011.

Determine the Insurance Claim.

(Nov-2013, PM) (Ans.: Net claim: 6,739)

Problem 12: Determination of claim in loss of profit policy: A trader intends to take a loss of profit policy with indemnity period of 6 months, however, he could not decide the policy amount. From the following details, suggest the policy amount:

Rs.

Turnover in last financial year	6,75,000
Standing charges in the last financial year	1,14,750

Net profit earned in last year was 10% of turnover and the same trend expected in subsequent year.

Increase in turnover expected 30%.

To achieve additional sales, trader has to incur additional expenditure of Rs.42,500.

(N - 15) (Ans.: Policy amount Rs.2,79,425)

Problem 13: Determination of claim in loss of profit policy: M/s. Platinum Jewellers wants to take up a "Loss of Profit Policy" for the year 2015. The extract of the Profit and Loss Account of the previous year ended 31-12-2014 provided below

Variable Expenses

Cost of Materials	18,60,000
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Fixed Expenses

Wages for skilled craftsmen	1,60,000
Salaries	2,80,000
Audit Fees	40,000
Rent	64,000
Bank Charges	18,000
Interest income	44,000
Net Profit	6,72,000

Turnover is expected to grow by 25% next year.

To meet the growing working capital needs the partners have decided to avail overdraft facilities from their bankers @ 12% p.a. interest

The average daily overdraft balance will be around Rs. 2 lakhs.

The wages for the skilled craftsmen will increase by 20% and salaries by 10% in the current year. All other expenses will remain the same. Determine the amount of policy to be taken up for the current year by M/s. Platinum Jewellers. (May 2015) (Ans: policy amount Rs13,47,500)

ABC ANALYSIS

	A Category	B Category	C Category
Class Room Problems	5,6,7,8,9	1,2,3,4	10,11
Assignment Problems	2,4,5,6,9,10	1,3,7,12, 13	11

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To **MASTER MINDS**, Guntur

Verified by: Mahesh Sir, G.S.R.Sir

Executed by: Sai Ram Sir

THE END